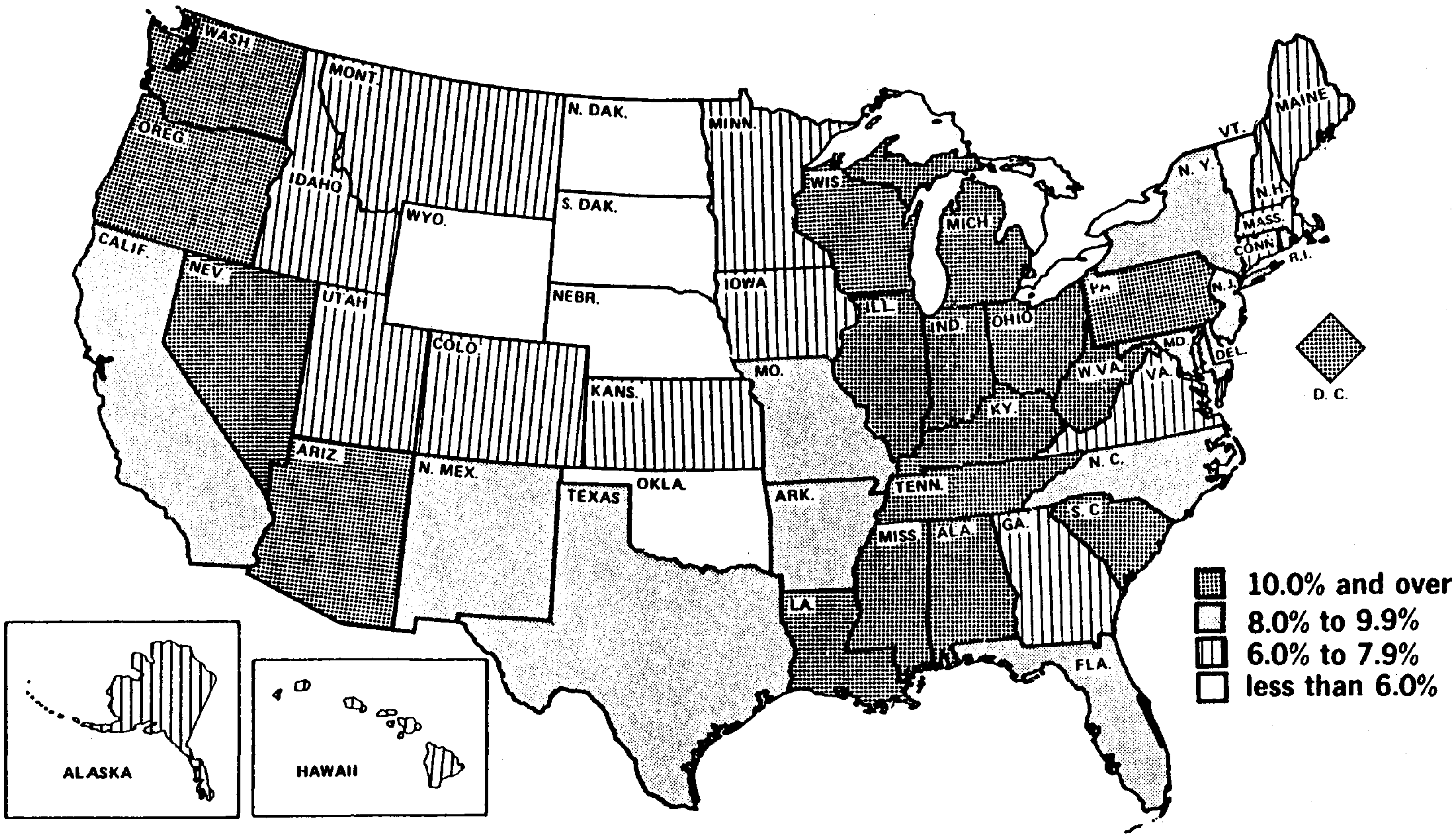
FIGURE 1. UNEMPLOYMENT RATES BY STATE, SEPTEMBER 1982



Source: U.S. Department of Labor, Bureau of Labor Statistics, November 1982

current levels. Furthermore, signs do not point to a rapid rebound in employment when recovery does take hold. A real economic growth rate of 3 to 4 percent per year, for example, implies a decline in the unemployment rate of only about 1 percentage point per year.

Structural unemployment poses additional problems. Persons with few or no marketable job skills, and employees displaced from declining industries with little prospect of being rehired by their former employers will continue to have employment problems even in a growing economy. For chronically disadvantaged persons, intensive training may be required to improve their long-term prospects. For persons displaced from declining industries--so called dislocated workers--job search assistance, aid in relocating to areas where their present skills may be in demand, or retraining may be necessary.

III. THE ECONOMIC CONTEXT OF EMPLOYMENT POLICY

The prospect of high jobless rates in the near term, and the realization that employment problems will remain for some persons even after recovery is well under way, have prompted a number of recent proposals for creating jobs and for addressing longer-term employment difficulties. This section examines the economic context within which employment policy options must be considered, and presents some of the broad choices that would need to be made.

THE ECONOMIC AND POLICY CONTEXT

The most recent upswing in unemployment has occurred during an extended period of weakness in the economy that is largely the result of a restrictive monetary policy (designed to reduce inflation) interacting with an expansionary fiscal policy--that is, one in which government spending is far in excess of revenues. Although nominal interest rates have fallen recently, real interest rates--after taking into account inflation--remain high. What is more, deficits are likely to rise to a level in excess of $150 billion during each of the next several years, unless further action is taken to increase revenues or constrain spending.

Substantial improvement in the overall unemployment picture awaits a return to sustained economic growth. However, the unique combination of monetary restraint and high deficits now in place severely limits traditional fiscal policy responses. Traditionally, the fiscal policy response to recessions has been higher spending, tax cuts, or both. Since the present fiscal policy is already expansive, giving it freer rein might risk driving up long-term interest rates --which might in turn largely offset the additional fiscal stimulus.

It is within this context that proposals have been made to address directly the problems of some limited number of the unemployed. While such proposals could improve circumstances for some unemployed persons, the impact on overall economic conditions would likely be limited. For one thing, short-term employment stimulus programs of any feasible size could directly aid only a small proportion of the unemployed and could only marginally affect the state of the economy at large. Also, for such programs to produce a net stimulative effect would require that they represent a net expansion in economic activity. Yet there are only two ways of financing these programs--increased tax revenues or increased federal borrowing--either of which might act to offset the desired expansion.

Programs that would simultaneously raise taxes and spend the proceeds would, as a first approximation, result in little or no net job creation. This is because the increased tax burden would, for the most part, reduce household and business spending. Thus, the job losses from higher taxes would eventually roughly offset the jobs created by the enlarged public spending. Proposals of this nature might therefore be evaluated on other grounds. One major criterion might be whether the new output—better highways, expanded public services, and so on—would be worth the costs of the program. In addition, a tax-financed program could change the distribution of unemployment and employment among industries, so the desirability of such shifts might also be a consideration. Finally, depending on the timing of the tax and spending increases, more jobs now might effectively be traded for fewer jobs in the future—when the overall level of unemployment is expected to be lower. This outcome might be achieved, for example, if spending were increased quickly but the tax increases were postponed until future years, providing the monetary authorities acted to prevent a rise in interest rates in the near term.

Increased spending without concurrent increased taxes, by contrast, would encounter certain risks. The direct impact of such programs would be to increase employment, but the concomitant increase in the federal budget deficit might limit the net increase in jobs. With unchanged monetary policy, interest rates might rise, thereby offsetting part or all of the

stimulus. Loosening monetary policy to avoid an increase in interest rates in the short run might lead to higher inflation and a rise in long-term interest rates, thereby attenuating the jobs-creation results. On the other hand, a plausible shift toward expectations of better future markets for goods and services as a result of the stimulus program could actually strengthen the job-creation effects.

The Congress has to decide whether, on balance, the current employment outlook and the recently improved state of inflation may warrant taking the risks associated with short-term stimulus options. These risks could be minimized by designing stimulus programs that need not have substantial impacts on budget deficits in the longer term. For example, programs in which spending could be ended after the cyclical need had passed could be emphasized, or offsetting tax increases could be scheduled to take effect in future years.

BROAD POLICY CHOICES

If the Congress chooses to provide some additional assistance to the unemployed, it will first have to determine what broad policy objective is to be pursued. Two general approaches are available. First, the Congress could choose to address cyclical unemployment problems as a way of expanding job opportunities immediately for those unemployed persons who

are most severely hurt by current conditions. Alternatively, the Congress could focus on the structural employment problems that will leave large numbers of persons ill-equipped to find work even after a recovery is under way.

Quite different options might be appropriate to these different objectives. If the primary objective is to provide immediate assistance to those persons who have been most severely hurt by the present economic downturn, the Congress might be most concerned about quickly providing targeted job opportunities or additional income support. If instead the principal focus is on longer-term employment problems, the Congress might wish to concentrate on training or job-search assistance for disadvantaged or dislocated workers. Both sets of objectives could, of course, be pursued simultaneously through some combination of programs.

Section IV of this analysis examines specific options for addressing cyclical employment problems. Section V focuses on ways to deal with structural unemployment.

IV. OPTIONS FOR ADDRESSING CYCLICAL EMPLOYMENT PROBLEMS

Several approaches have been proposed for alleviating cyclical unemployment problems. These approaches—all of which have been employed in prior recessions—include:

- Expanded infrastructure construction or repair programs;
- Other public employment programs;
- Countercyclical revenue sharing;
- Countercyclical housing subsidies;
- Wage subsidies for new private-sector employees; and
- Expanded or redirected Unemployment Insurance.

These approaches differ appreciably. Expanded infrastructure programs would provide a boost to construction employment and to employment in the industries that supply materials used in the physical improvements. Grants to finance other public services, by contrast, would probably be directed more toward providing immediate income support to a larger number of lower-skilled workers. Countercyclical revenue sharing would shift to states and localities the full responsibility for determining how the additional funds were used. Countercyclical housing subsidies would be aimed at spurring additional activity in one specific sector of the private economy. Wage subsidies would be intended to generate additional

hiring throughout the private sector. Finally, the Unemployment Insurance program could be used to provide additional income support for unemployed workers with prior labor market experience, or to hasten their reemployment.

Several criteria might be used in assessing countercyclical employment expansion options. The principal concern might be how many new jobs would be created in the short run. Job creation under any employment stimulus program has several aspects, however. The first is the number of jobs created directly in publicly financed projects and in the industries that supply materials for those projects--so-called direct job creation. The second aspect of job creation is employment that occurs as a result of the direct job creation--primarily as those hired directly spend their additional income. This is often referred to as indirect job creation. The sum of both direct and indirect job creation is often referred to as the "gross" number of jobs created. On the other hand, for any job creation program, there will also be several offsetting factors. These factors include the number of persons who would have been hired even in the absence of federal aid and the possible reductions in private-sector employment that would result from any simultaneous tax increase. The number of jobs created, or lost, after all such offsetting factors are taken into account is often referred to as the "net" number of jobs created. Each of these elements in turn--gross direct

employment, gross indirect employment, and net job creation—is increasingly difficult to measure and predict.

Other possible issues in assessing countercyclical employment options include whether the new jobs would be targeted on the persons in greatest need, and how much income support would be provided to those who would benefit. Any countercyclical stimulus program might also be judged on how valued the additional goods and services generated in the short-run would be, and how much the program would contribute to long-term productivity gains. A final criterion might be how rapidly the assistance would be made available, although this might be of less concern under present circumstances, in light of the expectation that joblessness will remain high for some time to come.

The remainder of this section analyzes the six countercyclical strategies listed at the outset. For each approach, prior federal experience is examined,1/ implications are drawn from that experience, and specific options are discussed.

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1. To the extent that they are available, the results of program evaluations are presented. Considerable caution should be exercised in interpreting the results of those evaluations, however. For one thing, the different economic circumstances in which prior countercyclical programs operated affect their impacts. Also, evaluations of prior programs often use quite different methodologies, which can make the results noncomparable--particularly regarding the crucial question of net job creation.

INFRASTRUCTURE IMPROVEMENT PROGRAMS

Increasing federal funding to states and localities to finance improvements to the nation's public infrastructure--roads, bridges, sanitation systems, and other public facilities--could expand employment opportunities in construction and in certain industries that supply building materials and, at the same time, improve the efficiency of the economy in future years.

Past Experience

The federal government has increased spending for infrastructure improvements several times during recent decades as a means of expanding short-term employment opportunities. The most recent such program was the Local Public Works (LPW) program, which awarded $6 billion to states and localities between July 1976 and September 1977 to fund 10,600 projects, principally in areas of high unemployment.2/ The LPW program represented a joint effort of the federal government and state and local governments, with the federal government--through the Economic Development Administration (EDA) in the Department of Commerce--funding projects from a wide range of proposals submitted by state and local governments.

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2. This summary of the Local Public Works program is drawn from: U.S. Department of Commerce, Economic Development Administration, **Local Public Works Program: Final Report**, December 1980.

The LPW program generally funded small-scale projects, costing an average of $570,000, with none larger than $5 million. About 55 percent of LPW funds were used to finance the construction of new facilities; another 12 percent were used for additions to existing facilities; and the remaining funds were used primarily for rehabilitation and repairs. Sanitation projects—water, sewer, and utility systems--accounted for about a fifth of total funding. Streets and bridges, schools, and municipal buildings each accounted for between 10 and 20 percent of total funding. Virtually all of these projects were estimated to have been net increases in construction at the time; that is, they were projects that state and local governments would have funded only at a later date, if at all.

About 22 percent of LPW funds were spent directly on labor, employing approximately 1.1 million people at one time or another, mostly in short-duration construction jobs averaging less than one month. Measured by person-years of employment, LPW directly created 93,000 jobs. Nearly two-thirds of those hired on LPW projects were skilled workers—virtually all members of construction trades. In addition, 28 percent of the workers were classed as unskilled and 9 percent as administrative personnel. About 13 percent of those hired on LPW projects were unemployed at the time they were hired. In addition, some share of those who were previously employed would likely have become unemployed had LPW not provided them jobs, though it is not possible to estimate how many.

The remaining four-fifths of LPW funds, which were used to purchase materials, created an estimated 66,000 person-years of employment in such supplying industries as concrete and steel manufacturing. Thus, the LPW program is estimated to have created about 159,000 person-years of employment directly at a cost of about $38,000 per job-year in 1978 dollars.3/

Most of the effects of LPW, however, were felt during the economy's recovery. The peak of LPW spending came in 1978--nearly four years after the trough of the recession and two years after passage of the initial LPW authorizing legislation (see Figure 2). By that time, unemployment was back at approximately its pre-recession low, and the additional public works spending is regarded as having been procyclical--probably contributing to inflationary pressures of the late 1970s.4/ The slowness of LPW spending was due in part to the timing of Congressional action in authorizing the program, and in part to the lags inherent in planning and carrying out public works projects.

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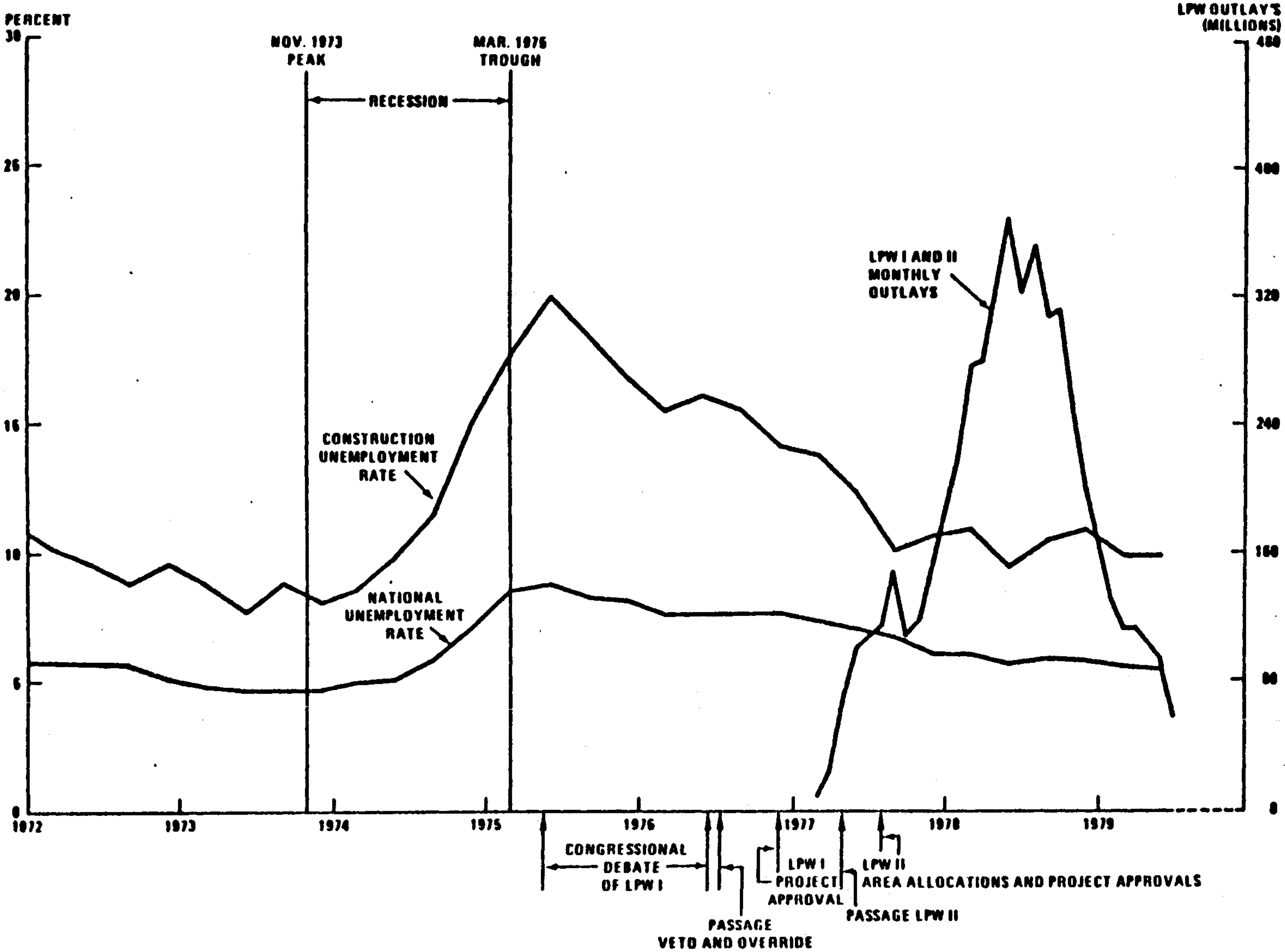
3. These figures reflect only those persons employed on-site on LPW projects, administrative personnel, and persons employed in producing materials used on LPW projects. The number of jobs created and the cost per job do not reflect indirect employment that occurs as those employed directly and in supplying industries spent their wages on goods and services.

4. Office of Management and Budget, **Public Works as a Countercyclical Assistance**, November 1979, p. 1.

FIGURE 2. DISTRIBUTION OF LOCAL PUBLIC WORKS OUTLAYS IN RELATIONSHIP TO NATIONAL UNEMPLOYMENT RATES



Seasonally adjusted, quarterly unemployment rates

SOURCE: Office of Management and Budget, Public Works as Countercyclical Assistance, November 1979, p. 3.

Policy Implications and Options

In general, public works programs create employment principally for relatively high-wage and high-skill construction workers and for workers in supplying industries. Such programs also generally require more time to generate these effects than do other types of countercyclical strategies. Depending on the program structure and financing mechanism, however, public works programs might be a vehicle for assisting industries significantly hurt by the current recession and for improving overall efficiency in the economy by providing needed infrastructure repairs.

At least two major approaches exist for public works spending increases. The federal government could serve primarily as a financing source--as it did with the LPW program--allowing state and local governments to submit funding proposals for a wide range of projects to a designated federal agency, and then funding selected projects. Alternatively, the federal government could increase funding for existing national programs--such as the activities of the Federal Highway Administration or the Environmental Protection Agency--that would meet various national infrastructure needs.

Funding a State- and Local-Designed Program. If the federal government chose to fund an LPW-like public works program, a number of

design issues would have to be addressed. First, a federal agency would have to be designated to administer it. The EDA would be one possibility, as would the Department of Housing and Urban Development, which reviews and funds capital projects through the Urban Development Action Grant program, and the Farmers Home Administration in the Department of Agriculture, which provides infrastructure funding through its rural development programs. The choice of agency might affect the speed with which a program could be implemented, although if high unemployment persists for some time, this might be of less concern.

A second issue would be which governments to assist. One option would be to limit aid to localities experiencing relatively high levels of unemployment. Alternatively, given the widespread nature of cyclical unemployment, all states and general-purpose local governments could be eligible, with such criteria as the current unemployment rate and fiscal distress of jurisdictions considered in selecting the applications to be funded.

Finally, a set of eligible activities would have to be determined. A wide range of new construction and repair activities could be permitted, as was the case in the LPW program, with priority given to projects that had high labor needs and that produced large numbers of jobs. Alternatively,

projects could be limited to rehabilitation and repair activities that require relatively large numbers of low-skilled workers, such as painting public buildings or repairing local roads.

Increasing Funding for Federal Infrastructure Programs. A second major option would be to increase funding for the major federal programs that address infrastructure needs. These programs include the activities of the Federal Highway Administration--already slated by the House of Representatives for major increases; waterway and land-based projects undertaken by the Army Corps of Engineers; waste-water treatment plants and other facilities provided by the Environmental Protection Agency; and airport and air traffic control facilities of the Federal Aviation Administration, among others.

In general, increases in funding for federal infrastructure programs would not necessarily lead to rapid employment gains, nor to large numbers of jobs, although such funding increases could lead to long-term increases in the efficiency of the economy. Federal infrastructure programs generally require fairly long periods in which to design and implement projects. Directing additional funding to projects already planned, however, could decrease these lags, depending on the number of such projects available and their actual state of readiness. Further, infrastructure programs generally employ relatively high-wage workers in construction and in supplying

industries, suggesting that infrastructure programs would create fewer jobs for a given federal expenditure than programs that fund activities performed by lower-wage workers. On the other hand, the nation's infrastructure is in need of significant funding increases, particularly for repair. Additional funding could create long-term gains in productivity by enabling the overall economy to function more efficiently.

If the Congress chose to undertake major improvements to the nation's infrastructure, serious attention would have to be paid to the manner in which these increases were financed. Historically, many of these capital facilities have been financed by the direct beneficiaries through user fees, such as motor fuels taxes--an approach that helps assure that useful projects are undertaken. Raising fees would, however, merely transfer resources--and jobs--from private-sector activity to public, thus creating few, if any, jobs on net. In fact, the effects on employment would be negative, if taxes were raised immediately and the increased federal outlays did not occur until sometime later--although in the short-run the increased revenues would reduce the federal budget deficit. These negative effects could be reduced by phasing in tax increases to correspond to the expected federal expenditure increases. And employment could be raised in the short run, by increasing federal spending immediately and raising user fees in the future to finance the increased activity, providing that monetary

authorities acted to avoid increases in interest rates that could result from having to finance a higher deficit in the short run.

OTHER PUBLIC EMPLOYMENT PROGRAMS

Another approach to expanding employment opportunities would be to finance jobs in federal, state, local, or nonprofit agencies providing other public services. Under this approach, a greater share of the federal expenditure would go directly to wages than is the case with public works projects, and the additional short-term employment could probably be generated more quickly. On the other hand, the jobs created would generally be lower paying, and in past public employment programs some questions have been raised regarding the value of the additional services provided.

Past Experience

The federal government has used public service employment (PSE) programs twice in the recent past to address the problem of high unemployment--first through the Emergency Jobs and Unemployment Assistance Act of 1974 and later through the Economic Stimulus Appropriation Act of 1977. Both programs were part of the Comprehensive Employment and Training Act (CETA). At the peak in 1978, the federal government provided $5.8 billion to states, localities, and nonprofit organizations to finance

employment in such areas as law enforcement, education, transportation, and parks and recreation. Most of the PSE jobs were of short duration, however, lasting an average of about seven months. After their increase in the late 1970s, the PSE programs were cut back, but were retained as part of CETA. These programs were eliminated in the 1981 Reconciliation Act.

The types of people employed in PSE jobs, the wage levels paid, and thus the average federal cost per worker have all varied over time. The 1974 program provided jobs to persons who had been unemployed at least 30 days and to low-income persons who were working. In 1976, however, the program was more heavily targeted on low-income persons, in response to perceptions that too few jobs were going to those most in need and that too few of the PSE jobs represented net new employment. These restrictions were later relaxed to accommodate the rapid 1977-1978 program expansion. During the expansion, the number of jobs increased rapidly—an average monthly expansion of 40,000 jobs—and criticisms of fraud, abuse, avoidance of more disadvantaged persons, and job substitution arose again. In response, the 1978 CETA reauthorization increased the focus on the disadvantaged and reduced the maximum allowable wage level. In fiscal year 1981, each person-year of employment funded through PSE programs cost approximately $11,000 in federal outlays.